

**COMMENTS OF CONSTELLATION ENERGY COMMODITIES GROUP, INC.
ON THE ILLINOIS POWER AGENCY'S DRAFT 2011 PROCUREMENT PLAN**

Now comes Constellation Energy Commodities Group, Inc. ("CCG" or "Constellation") and, pursuant to Section 16-111.5 of the Public Utilities Act (220 ILCS 5/16-111.5), submits these comments to the Illinois Power Agency ("IPA") draft procurement plan ("Draft Plan") for the generation supply for Commonwealth Edison Company and Central Illinois Light Company d/b/a AmerenCIPS, Central Illinois Public Service Company d/b/a AmerenCIPS, and Illinois Power Company d/b/a AmerenIP (collectively, "the Ameren utilities") for retail customers being served by the utilities beginning in June 2011 through May 2016.

Background

CCG is a power marketer authorized by the Federal Energy Regulatory Commission to sell energy and capacity and certain ancillary services at market-based rates. CCG focuses on serving the needs of distribution utilities, co-ops and municipalities that competitively source their load requirements. CCG also sells natural gas and other commodities at wholesale, both in the United States and abroad, and holds interests in exploration and production companies. CCG does not own any physical assets for the generation, transmission, or distribution of electric power and has no retail electric customers or service territories. However, CCG bids energy, capacity and ancillary services on behalf of generation-owning affiliates into the markets administrated by PJM Interconnection, L.L.C. and the Midwest Independent Transmission System Operator, Inc.

CCG has participated in the competitive procurement processes under which contracts for the electric power and energy needs of Ameren and ComEd in the post-

transition period were bid and awarded. In the 2006 auction process, CCG was awarded certain tranches in the ComEd and Ameren auctions. In the 2008 and 2009 competitive procurement process, CCG was an active participant in the Commission proceedings that resulted in the adoption of the utility procurement plans as well as all of the related activities conducted by the Procurement Administrators leading up to each of the procurement events that preceded the initial IPA plan. CCG submitted bids, and was one of the winning bidders, in several of those events.

However, based upon CCG's experiences in procurement events in Illinois and elsewhere, CCG recommends that the Draft Plan be modified such that the Final Plan relies upon the use of full requirements products as opposed to its sole reliance upon the use of standard wholesale block products. Such an approach will minimize customer risk, best fulfills the IPA's statutory mandate, and relies upon wholesale suppliers superior expertise in managing portfolios.

Use Full Requirements Products To Minimize Customer Risks

In order to procure supply required to meet the needs of "eligible retail customers", as defined within the Public Utilities Act, the Draft Plan should be modified to use full requirements ("full requirements") products. The IPA is given discretion to procure products individually, or in combination.¹ The IPA should take into consideration the fact that customers bear greater risk with separate block products, because the shape and quantity of the load is not known, and should modify the Draft Plan accordingly by procuring full requirements contracts.

¹ 220 ILCS 5/16-111.5(b)(3)(iii).

The benefits offered by a full requirements approach have never been greater than this upcoming procurement cycle due to the likelihood that the number of utilities' bundled customers and underlying load will be reduced -- potentially dramatically -- during that time. The advent of purchase of receivables/utility consolidated billing, an increasing number of ARES indicating an interest in serving residential and small commercial customers, and the development of various websites and referral programs, among others, support the proposition that "the policy of supporting competitive electricity markets will continue and strengthen, and that eligible retail consumers currently served through the IPA portfolio migrate towards ARES options." (Draft Plan, pp. 8-9). As the IPA acknowledges, these "recent developments indicate that significant reductions to the barriers to retail competition in residential markets are on the near-term horizon." (*Id.* at 15). As a result, "[t]he portfolio is exposed to load uncertainty risk." (*Id.*)

The Full Requirements Approach Best Fulfills the IPA's Statutory Mandate

A full requirements approach will best meet the requirements of Illinois law. It is important to keep in mind that "costs" to customers may include not only the prices paid by customers for IPA-procured supply, but the risks and lost opportunities they may face under a particular IPA plan. A full requirements approach will limit risks to customers by shifting them from the IPA, ComEd and Ameren to wholesale suppliers, while promoting opportunities for customers by providing well-defined, competitively-procured default service supply that provides appropriate benchmarks for comparisons to product offerings of retail electric suppliers ("RESs").

As risks and costs to ComEd and Ameren appropriately are passed on to its customers, it follows that the full requirements approach limits the risk to utilities' customers by shifting them largely to full requirements product suppliers. To explain, full requirements products provide consumers with insurance for the duration of the contract by shifting risk to wholesale suppliers. The situation faced in 2008 by Wellsboro Electric Company ("Wellsboro") – a Pennsylvania utility procuring its default service requirements through a managed portfolio approach – provided documented evidence as to the benefits of shifting such risk; Wellsboro faced a market "surprise" and had to seek permission from the Pennsylvania Public Utility Commission on January 30, 2008 to recover in excess of \$2 million in additional congestion costs from its customers because of an unexpected congestion event.² Wellsboro's customers did not have the "insurance" provided by a full requirements supplier for such an event and, as a result, had to bear the burden themselves for the surprise rise in costs, as the Pennsylvania Public Utility Commission approved the pass through of such costs on February 28, 2008.³

An IPA plan relying on full requirements products provides a proper balance by obtaining the most competitive prices for consumers, while appropriately placing risks such as volume risk on wholesale suppliers. Support for this notion comes from an important study on Pennsylvania's energy future by Dr. Susan F. Tierney, a nationally recognized energy policy expert, former Assistant Secretary for Policy at the U.S. Department of Energy, and former Commissioner at the Massachusetts Department of

² See *Joint Statement of Commissioner Kim Pizzigrilli and Vice Chairman James H. Cawley*, Commission Docket No. P-2008-202057 (issued Feb. 28, 2008) ("Wellsboro Feb. 2008 Decision") at p.1.

³ See Wellsboro Feb. 2008 Decision at p.1.

Public Utilities.⁴ Dr. Tierney documents that, through competitive full requirements procurements, wholesale suppliers bring many benefits because of their abilities and skills.⁵

Bidders Possess Superior Expertise In Managing Portfolios

A diverse pool of wholesale full requirements product suppliers provide the most cost-effective method of management for eligible retail customers. Under full requirements product procurements, utilities provide to potential bidders prior to procurements, and to winning bidders on an ongoing basis afterwards, all of the load data for their individual customer classes. Wholesale suppliers are specialists in the area of portfolio management, and have greater resources, expertise and ability to appropriately utilize this data to manage portfolios of supply at the least possible cost, by allocating the costs for their operations over much larger load obligations throughout the country. Moreover, such suppliers are able to draw from their substantial experience throughout PJM, MISO and in other jurisdictions to develop proprietary models of customer behavior and switching patterns, to refine these models, and to better analyze the local data provided by utilities. These wholesale suppliers pass on the efficiencies they achieve due to their sophisticated risk management skills and experience in the form of more competitive bids for full requirements products in competitive procurements. Wholesale suppliers have already invested in, and continue to make significant investment in acquiring, experts in each specific type of market which makes up full requirements supply.

⁴ See *Pennsylvania's Electric Power Future: Trends and Guiding Principles*, Susan F. Tierney, Ph.D., Analysis Group (January 2008) ("2008 PA Market Study").

⁵ See 2008 PA Market Study at p.11 (stating that full requirements service "taps into the abilities and skills" of different wholesale market participants).

At Constellation, for instance, hundreds of employees are involved in the process of providing full requirements service to utilities and customers around the country, serving tens of thousands of megawatts of various types of full requirements load from coast to coast. Constellation employs a team of seasoned portfolio managers for large regional portfolios that serve Constellation's customers' full requirements loads. Constellation must ensure that any transaction that goes into Constellation's entire portfolio of obligations is accounted for at the end of each day, and that requirements for the entire load are met continuously for every hour of every day of every week. A team of strategists continuously develops and improves computer models to keep track of all of the variable inputs that go into providing full requirements service; these strategists provide and analyze various scenarios that Constellation's portfolio managers may face. In addition, a fundamentals group constantly researches basic supply and demand in fuel and power markets in order to monitor macroeconomic trends that affect the costs of serving load. A 24-hour power trading desk trades power in the hour ahead, day ahead, and week ahead markets each day of the week, in order to help manage Constellation's supply portfolio. Moreover, power managers and traders monitor and trade in not only the PJM and MISO markets, but also those in New York, New England and other markets throughout the U.S.; fuel managers do the same as fuel markets have direct effects on power markets. Similar resources focus on fuel oil, natural gas, coal, currency, emissions and renewable energy markets. Full-time meteorologists on Constellation's team continually monitor and predict the weather, so that Constellation's team can plan for weather effects on load requirements, and adjust supply accordingly. The task of meeting full requirements load supply additionally requires controllers, schedulers and

dispatchers. Supporting all of these operations is a team of regulatory specialists and attorneys that monitor and participate in regulatory and legal activities which affect energy markets.

A wholesale supplier's greater expertise in these activities represents a valuable asset in evaluating and engaging in transactions for not only for complex hedges and other energy products, but for more common products in a portfolio such as block and spot market purchases. Increased levels of expertise and the ability to take on and manage a large portfolio's risks and responsibilities enable a wholesale supplier such as Constellation to provide significant competitive benefits over a smaller, less sophisticated market participant. Moreover, a wholesale supplier has the added expertise necessary to enter into more complex transactions which can provide additional appropriate management and hedging tools to further drive down costs.

Each of the tasks and positions described for Constellation's team plays an integral role in being able to drive down a wholesale supplier's costs of meeting load requirements and provide the most reliable, up-to-the minute improvements and adjustments to a portfolio of resources, from which all of the supplier's customers will benefit. Without the benefits of accurate and around-the-clock weather monitoring and predicting, if an IPA plan estimates a need and purchases block products ahead of time to meet a utility's expected eligible retail customer load for the summer, one can, for instance, evaluate a situation where there happens to be an unusually hot week in the middle of July. The utility may face a situation where, because of the unusually hotter weather, homes and businesses are requiring *much* more electricity to run their air conditioners. If the IPA plan did not accurately predict how much load it would have in

that week, because of that inability to accurately predict and react to the weather, the utilities may face a situation where they need to purchase in the spot market the additional supply that it requires at *high* electricity rates because, as demand for electricity increases around the region during a hot week, supply becomes constrained and prices for limited supply increase. The utility's consumers will bear the burden of the costs of this inability to accurately predict and plan for the weather in real-time.

Constellation and other wholesale suppliers continually monitor and predict the weather as part of their portfolio management function and are able to react in real-time and adjust supply accordingly and efficiently, with an incentive to keep costs low. The costs for all of the above types of expertise are mitigated significantly by utilizing a well-developed infrastructure and spreading the overhead for such activities across a supplier's entire portfolio of tens of thousands of megawatts of supply obligations across the country. Additionally, the costs for full requirements product suppliers to provide such service for a utility's eligible retail customers will be highly constrained by the very competitive nature of this business, because wholesale suppliers throughout the market have operations similar in structure to those of Constellation, and will compete to serve a utility's eligible retail customers at the lowest cost. In addition, it is important to point out certain significant results from a recent analysis ("2010 Procurement Structure Analysis") conducted on behalf of Narragansett Electric Company d/b/a National Grid's ("National Grid"), and filed in the Rhode Island Public Utilities Commission's ("RIPUC") proceeding to consider National Grid's procurement structure for Standard Offer Service ("SOS"), Rhode Island's equivalent of utility supply service to eligible

retail customers.⁶ The 2010 Procurement Structure Analysis provides an important and unique technical assessment based on advanced modeling, to compare and contrast “the relative costs and risks of different approaches to serve mass market customers, and how different approaches could impact customers’ supply rates.”⁷ While the Analysis suggests that a managed portfolio approach may, in fact, generally be cheaper than a full requirements structure, it is cheaper only by the narrowest of margins – *roughly only \$0.72/MWh*.⁸ However, for this very limited benefit in cost due exclusively to the price for supply, consumers will be faced with *considerably more costs due to increased risks*.⁹

Any Incremental Premium Is Outweighed By Insulating Customers From Risk

It is true, however, that wholesale suppliers bidding on full requirements products may indeed place a certain value on the risk that they assume, for instance, for customer migration. The calculation for this monetization will depend on an individual wholesale supplier’s perception of the level of such risk, its ability to manage the risk and its appetite for assuming the risk. By removing the potential for monetization and management of this risk by suppliers, a managed portfolio approach takes the actual risk and places it on consumers. In other words, it is a zero sum game. Customers bear each “cost,” either in the price or in the form of an assumed risk. This type of shifting of risks directly to consumers fundamentally alters the nature of the product being provided .

⁶ *Analysis of Standard Offer Service Approaches for Mass Market Customers*, RIPUC Docket No. 4041 (submitted Jan. 22, 2010) (“2010 Procurement Structure Analysis”)

⁷ 2010 Procurement Structure Analysis at p.2.

⁸ *See* 2010 Procurement Structure Analysis at p.12 and p.15 (explaining that the full requirements Structure results in an expected SOS rate of only \$0.72/MWh more than an alternative Managed Portfolio Approach).

⁹ *See* 2010 Procurement Structure Analysis at p.20.

Proponents of a managed portfolio approach often make claims that these monetizations and costs are exclusive to full requirements products. This claim, however, represents the false assumption that products such as block products in a managed portfolio approach will avoid (or else place on customers) most of the risks that are monetized in a full requirements product. In fact, block products include all of the same risks – and, in turn, monetization of risks – as full requirements products for items including, but not limited to, rising fuel costs, inflation, new energy taxes, market rule changes, market price changes prior to bid acceptance, and changes in credit standing. It follows that the only risk that may not be priced into the costs for block products is that of load variation, including variation due to customer migration. However, as explained above, if the fixed costs for the added benefits of full requirements products – *including* for load variation – are highly constrained through the competitive nature of full requirements product procurements, then it would be difficult to imagine that a managed portfolio approach could result in more competitive prices than those achieved under the full requirements product procurements.

Detractors of full requirements structures also often suggest that a profit is added into a bid which is otherwise avoided when purchasing other products that may be procured under a managed portfolio approach. In reality, any product that is purchased in the wholesale markets – e.g., whether a full requirements product, a block product or a spot market purchase – will include in its price some level of profit that the supplier is willing and able to receive. Basic economic principles suggest that this is the case. When a seller sells a product – whether he is selling oranges, widgets or electricity – he seeks a return on his costs of producing the product. Basic economic principles also

suggest that the price that a seller is “willing” to sell his product for will be constrained by the price he is “able” to sell his product for, so that in a competitive procurement, where only the lowest price from a pool of sellers is accepted, each seller will have an incentive to drive down the price at which he is “willing” to sell his product. This competitively constrained price for a full requirements product will include a seller’s perceived monetizations of risk as well as a profit on the overall full requirements product. Depending on a supplier’s perception of the level of risks, its ability to manage risks and its appetite for assuming risks, a supplier may have an ability to drive down further its underlying costs and overall prices. This especially is true for suppliers that are able to spread their costs across a large portfolio of supply obligations – if a supplier experiences lower revenue or a loss due to one of its obligations, for example, it is able to offset it against earnings across its entire portfolio of obligations. A utility relying on a managed portfolio approach has neither the competitive incentives to drive down its costs for managing risks nor the ability to hedge its obligations and costs across a broad, multi-regional portfolio.

Finally, it is important to keep in mind that all of these allegations against full requirements products regarding relative costs appear not to be borne out when carefully analyzed – once again, the well-developed 2010 Procurement Structure Analysis suggests that the difference in consumers’ prices for accepting the costs of increased risks under a managed portfolio approach rather than placing such risks on suppliers through a full requirements structure is roughly *only* \$0.72/MWh.¹⁰

¹⁰ See 2010 Procurement Structure Analysis at p.12 and p.15 (explaining that the full requirements product structure results in an expected SOS rate of only \$0.72/MWh more than an alternative Managed Portfolio Approach).

Conclusion

As outlined above, reliance upon full requirements products achieves several benefits. The IPA can best access competitive wholesale markets by procuring full requirements products, rather than by trying to purchase individual components of service (*i.e.*, energy, capacity, RECs, etc.) on its own. Constellation therefore recommends that the IPA Draft Plan be modified as described herein.

Respectfully Submitted,

CONSTELLATION ENERGY COMMODITIES GROUP, INC.

A handwritten signature in black ink, reading "Cynthia Fonner Brady". The signature is fluid and cursive, with the first name "Cynthia" being the most prominent.

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Dated: September 15, 2010